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UNITED STATES BANKRUPTCY COURT

NORTHERN DISTRICT OF CALIFORNIA

In re Rome Finance Co., Inc, Debtor.	Case No. 08-45902 J Chapter 11 Date: January 15, 2009 Time: 9:30 a.m. Place: U.S. Bankruptcy Court 1300 Clay Street, 2d floor Oakland, CA 94612

Memorandum of Points and Authorities in Support of Acting U.S. Trustee's Motion For Appointment of Trustee

There are three reasons the Court should order appointment of a trustee in this case. First, there are serious questions about the legality of the Debtor's operations. The Debtor is not licensed as a finance lender. Historically and currently, its management has declined to bring it into compliance with state lending law. Second, in 2006 and 2007, the Debtor's principals have set up non-debtor corporations to which they are shifting the Debtor's business. This shifting occurred after state authorities filed enforcement actions against the Debtor for its continued violations of consumer lending law. Finally, there are serious conflicts of interests among the insiders of the the Debtor, including Mr. William Collins, who claims he is not an insider but who is closely aligned to Debtor's management and the Debtor's affiliates. Mr. Collins receives a consulting fee from the Debtor, receives a preferential interest rate on his notes, and is a shareholder in both companies to which the Debtor is shifting its business. In addition, the Debtor operates a parallel business for the benefit of Mr. Collins, bearing all the costs of that

business and allocating to Mr. Collins the gross profit.

I. Issues To Be Decided

A. Is there cause for the Court to order the appointment of a trustee under 11 U.S.C. § 1104(a)(1)?

B. Is appointment of a trustee in the best interests of creditors and other interests of the estate under 11 U.S.C. § 1104(a)(2)?

C. Is the appointment of an examiner under 11 U.S.C. § 1104(c) in the best interests of creditors and other interests of the estate ?

D. Is appointment of an examiner under 11 U.S.C. § 1104(c)(2) required because the Debtor's unsecured debts exceed $5 million?

II. Facts

A. Overview of Facts

The Debtor is a California corporation with offices in California and Georgia. The Debtor's sole shareholder, president and responsible individual is Mr. Ronald Wilson. The Debtor's largest investor is Mr. William Collins. The Debtor's business involves financing of consumer purchases in a number of states. The Debtor is financed by notes that it issues to investors. The Debtor's business model is problematic on both ends. The Debtor's financing business appears to violate the consumer protection laws or finance lender laws of some or all of the states in which it does business. (Currently the State of Tennessee is seeking a judgment against the Debtor for in excess of $10 million. There may also be liability under California and other state laws, to the states and to the individual consumers.) In addition, the Debtor's issuance of notes does not appear to accord with California's securities laws..

The Debtor's response to regulatory enforcement action also raises concerns about management's decision making. In 2006, the year after the State of Tennessee filed suit against the Debtor, Mr. Wilson and Mr. Collins set up a parallel (non-debtor) corporation, Rome Finance Corporation, (GA) LLC ("Rome LLC"), owned 45% by each of them and 10% by Jody Mohammed, carrying on a business identical to the Debtor's business. The Debtor has been shifting the Debtor's business to the non-debtor entity since that time. In addition, in 2007, Mr.

Wilson, Mr. Collins and three other individuals formed a separate (non-debtor) corporation, RCC of Georgia LLC ("RCC"), owned 20% by each. RCC buys the Debtor's bad accounts at 2% of face value and collects those accounts, thus shifting that portion of Debtor's business out of the Debtor. The Debtor also carries on a parallel businesses for the benefit of Mr. Collins' IRA. The Debtor, in fact, operates all three of these businesses, allocating expenses as Mr. Wilson decides. The Debtor has not recognized any claims against these non-debtor entities as a potential asset.

B. The Consumer Protection Litigation

The Debtor operates near military bases and finances purchases of consumer goods by soliciting active duty members of the U.S. armed services. The Tennessee Attorney General's Office brought suit against the Debtor for violations of consumer protection laws in 2005. According to the Attorney General, the Debtor's defense consisted largely of "delay, obfuscation, and outright misrepresentation." *Memorandum In Opposition To Emergency Motion For Temporary Restraining Order and Preliminary Injunction* filed by Attorney for the Tennessee Department of Commerce and Insurance-division of Consumer Affairs ("*Opposition to TRO")*, page 5, line 17. The Tennessee Attorney General's Office obtained a default judgment as the ultimate sanction against the Debtor for its ongoing bad faith in a civil law enforcement action. *Opposition to TRO*, page 2, line 7.

The Tennessee litigation may be a preview of other state actions. At the Debtor's meeting of creditors, Erik Brunkal, Senior Corporations Counsel for the California Department of Corporations, stated that he had advised Mr. Wilson two years earlier that the Debtor needed to be licensed under the California Finance Lender Law. Mr. Brunkal asked if the Debtor was so licensed. Mr. Wilson replied that it was not. In fact, according to the Debtors' schedules it is not licensed to act as a lender in any state.

The Debtor has listed a disputed, contingent, unliquidated claim by the State of Tennessee for an unknown amount. The Debtor has not listed claims by any other state or by any of its customers. Tennessee has asserted that its claim for fines, penalties and retribution to the servicemen will exceed $10 million. The possible claims of California, other states and other

individual servicemen has not been quantified. There is a strong likelihood that the consumer claims are a multiple of the $10 million claimed by Tennessee. None of the Debtor's customers, current or past, in or out of California, have notice of this bankruptcy. It appears that all of those customers may have claims against the Debtor under California or other state or federal consumer protection laws.

C. California Securities Law

At the meeting of creditors, Mr. Brunkal also asked Mr. Wilson whether the Debtor had qualified its promissory notes for offer and sale with the California Commissioner of Corporations. Mr. Wilson answered that the Debtor did not. Mr. Brunkal asked whether the Debtor had an exemption from the California securities law that allowed it to offer and sell securities without a license. The Debtor's counsel advised Mr. Wilson not to respond to that question because it involved a legal conclusion, and Mr. Wilson did not. Mr. Brunkal asked whether the Debtor inquired into the would be note holder's wealth and income before writing a note. Mr. Wilson responded that the Debtor did not. It appears from the Debtor's schedules that it has not been issued a permit or a license to sell securities in any state.

D. The Parallel Non-Debtor Corporation

The Debtor's assets include about $63 million of accounts receivable (at face value) and $1 million of cash. (Schedule B, items 2 and 16) In addition, the Debtor holds $37 million of accounts receivable and $1.2 million of cash for other persons. (Statement of Financial Affairs, Item 14) There is some confusion concerning the cash. At the meeting of creditors, Mr. Wilson testified that the cash held for others was kept in the Debtor's bank accounts and was part of the money described in Schedule B, Bank deposits. This is obviously not the case as the amount held for others is larger than the amount listed as in the bank accounts on Schedule B. The Debtor and its counsel stated they would investigate the discrepancy.

Of the amounts held for others, $25 million in accounts and $491,000 in cash is held for Rome LLC. At the meeting of creditors, Mr. Wilson testified that Rome LLC is a corporation set up in 2006 to conduct the same business as the Debtor. Rome LLC is owned 45% by Mr. Wilson, 45% by William Collins, and 10% by Jody Mohammed. Rome LLC's business is

identical to the Debtor's business. That is, it is financed by notes from investors (many of whom also hold the Debtor's notes) and finances consumer purchases by servicemen. The notes it issues are in its own name but the accounts receivable it finances are in the Debtor's name.

Rome LLC does not have employees or books and records of its own. Its records are kept by the Debtor's employees on the Debtor's computer system. Rome LLC's assets are identified on that system, and it is charged a portion of the overall business overhead allocated on the basis of its percentage of accounts receivable. Mr. Wilson determines which corporation acquires the accounts and which corporation issues notes.

E. The Parallel Non-Debtor IRA

The Debtor also holds $9 million of accounts and $579,000 of cash for the WR Collins IRA. Mr. Wilson testified that these assets were held for Mr. Collins' IRA in essentially the same manner as the accounts and cash held for Rome LLC. The big difference is that Mr. Collins' IRA is not charged any portion of the overhead expense.

William Collins is the beneficiary of the IRA. In addition to the IRA, he, entities related to him, and family members of his, hold a large percentage of the notes written by the Debtor. Mr. Collins and his family's notes receive 15% interest instead of the 12% that most note holders receive. In addition to Mr. Collins, only the Debtor's employees and Mr. Wilson and his family members receive 15%. In addition, Mr. Collins receives consulting income of $2,000/month from the Debtor, is 45% shareholder of Rome LLC, the parallel non-debtor and 20% owner of RCC of Georgia, LLC ("RCC") an entity explained below,[1]

F. RCC of Georgia, LLC ("RCC")

RCC was started in 2007 to act as a collection company. RCC buys accounts that are three years in arrears from the Debtor and tries to collect those accounts. It is owned,

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[1]Immediately before the Unsecured Creditors Committee was formed, the U.S. Trustee asked Mr. Bender, the attorney to the unofficial committee, to explain Mr. Collins' relationship to the Debtor. The U.S. Trustee was under the impression that Mr. Collins had originally approached Mr. Bender about setting up a committee. Mr. Bender reported to the U.S. Trustee that Mr. Collins and his family received the preferential rate and consulting payments. He said nothing of Mr. Collins IRA, or Mr. Collins interests in Rome LLC or RCC.

approximately 20% each, by Ronald Wilson, William Collins, Jay Kennedy, David Weaver and Guy Van Pool. Its accounts are purchased at 2% of their face value. Thus, the $424,012 of account value listed on SOFA No. 14 represents accounts with a face value in excess of $21 million. The Debtor also held $63,126 of cash for RCC at the time the case was filed. That cash has now been transferred to RCC. All of the employees of RCC receive their pay and their W-2s from the Debtor. Prior to selling these accounts to RCC, the Debtor collected them and retained the profits therefrom.

III. Argument

A. The Questionable Legality of Debtor's Business, Its Tactics in Addressing Those Problems With Tennessee and California, And Its Actions To Divert Profits To Parallel Entities Is Cause For Appointment of a Trustee.

Cause for appointment of a trustee is broadly defined to include "...fraud, dishonesty, incompetence, or gross mismanagement of the affairs of the debtor by current management, either before or after the commencement of the case, or similar cause..." 11 U.S.C. § 1104(a). The best reasoning is that the movant must prove the need for a trustee by a preponderance of the evidence.

> Having canvassed this case law, I have come to conclude that an appointment court need find the factual predicates–"cause" or the best interests of relevant parties–by only a preponderance of the evidence. More general Supreme Court reasoning in the bankruptcy realm suggests that the reflexive endorsement of a demanding "clear and convincing" evidentiary burden regarding trustee appointment under § 1104 is anomolous. In *Grogan v. Garner,* 498 U.S. 279 (1991), a unanimous Court determined that a preponderance of the evidence standard should be applied when determining whether the exception to discharge provided for by 11 U.S.C. § 523(a)(2)(A) had been met.

Tradex Corporation v. Phoebe Morse, 339 B.R. 823, 829(D.Ct. Mass. 2006). *See also In re Altman*, 230 B.R. 6, 16(Bkrtcy. Conn. 1999)("The debtor's argument that the requisite burden of proof is clear and convincing evidence is unavailing because the appropriate standard is a preponderance of the evidence...") However, to the contrary, *see In re Marvel Entm't Group, Inc.,* 140 F.3d 463, 471 (3d Cir.1998).

In this case, Debtor's conduct has resulted in enforcement action by the State of Tennessee for continuous consumer protection violations. Since the Tennessee Attorney General's Office has now obtained a default judgment against the Debtor for bad faith conduct in

the litigation, it appears that the State will prevail in obtaining a judgment exceeding $10 million in the enforcement action. Moreover, the actions by the Debtor in creating parallel businesses to which Debtor's accounts were transferred, taken after enforcement litigation was commenced, should by itself justify the appointment of a disinterested third party to review, and if necessary seek avoidance, of these transfers.

The Debtor faces similar consumer protection laws in California. Two years ago the Debtor was advised by EriK Brunkal, Senior Corporations Counsel, California Department of Corporations, to become licensed under the California Finance Lender's Law. The Debtor has not done so. Remedies for making consumer loans without a license include restitution, disgorgement, and damages. Willful violations carry civil penalties of $2,500 per violation and voiding the transaction. Fin. Code §§ 22713 and 22750.

In addition, Debtor appears to be violating California securities law. California Corporations Code § 25110 prohibits the offer and sale of securities in California unless they have been qualified by the Commissioner. A security is defined to include "any note." Cal. Corp. Code § 25019. The offer and sale of the Debtor's notes was not qualified under any section of the Corporations Code. Exemptions are available for accredited investors, but those exemptions require that the wealth and income of the investors be examined. The Debtor makes no effort to determine a potential noteholder's income or wealth. Thus it would appear the Debtor ignores California securities law. Each violation subjects the issuer to a $25,000 penalty, restitution and disgorgement of profits. Cal. Corp. Code § 25535. The burden of proving compliance with an exemption is on the issuer.

Debtor's past and ongoing failure to comply with state laws, its past litigation tactics, and its siphoning off of business to non-debtor entities, constitute justifying appointment of a chapter 11 trustee. Avoiding the laws of Tennessee by setting up parallel corporations alone is cause for appointment of a trustee. In similar factual situations, where the debtor has caused the siphoning of its assets to companies under common control, courts have determined that cause to appoint a chapter 11 trustee exists. See *In re Great Northeastern Lumber & Millwork Corporation,* 20 B.R. 610, 611 (Bkrtcy. E.D. Pa. 1982); see also *In re Sharon Steel Corp.*, 871 F.2d 1217 (3Cir.

1989)("appointment of Chapter 11 trustee was not abuse of discretion where there was evidence of systematic siphoning of debtor's assets to other companies under common control on eve of bankruptcy, and continuing postpetition mismanagement.") *In re V. Savino Oil & Heating Co., Inc.,* 99 B.R. 518 (Bankr. E.D.N.Y. 1989)(formation of second corporation to place debtor's operations beyond reach of creditors was cause for appointment of trustee).

B. Appointment of a Trustee is in the best interests of noteholders, consumer claimants and the public interest.

The mismanagement noted above justifies appointment of a trustee in the best interests of the estate as well as for cause. In addition, however, a trustee is needed in this case because the Debtor's current management cannot be relied upon to represent the interests of the consumer claimants, the public or even the noteholders.

The second paragraph of 11 U.S.C. § 1104(a) requires the Court to order appointment of a trustee if such appointment is in the interests of creditors, equity holders or other interests of the estate. In determining whether a trustee should be appointed in the interests of creditors, courts look to "practical realities and necessities." *In re Ionosphere Clubs, Inc*., 113 B.R. 164 at 168 (Bkrtcy..S.D.N.Y.,1990). Where the debtor's business affects a large segment of the general public, consideration of the "public interest" becomes a factor in deciding whether to order the appointment of a trustee. *In re Ionosphere Clubs, Inc* at 168 ("In this case, as has clearly been articulated by this Court time and time again, the flying public's interest must at all times be taken into account.") See also *In re The 1031 Tax Group, LLC*, 374 B.R. 78 (Bkrtcy.S.D.N.Y. 2007)("The twin goals of the standard for appointment of a trustee should be protection of the public interest and the interests of creditors ... and facilitation of a reorganization that will benefit both the creditors and the debtors...." (quoting House Report, 124 Cong.Rec. H11, 11 (daily ed. Sept. 28, 1978)).

Here, the consumer clients of the Debtor must be considered both as potential claimants, and as part of the public interest. As potential claimants, their impact on this case is unknown. Tennessee is seeking in excess of $10 million. There is no reason to doubt that California and the other states in which the Debtor lends (and potentially, individual soldiers as a group) will

seek comparable amounts. The states will probably be most interested in seeing the Debtor change its practices going forward. The Debtor's past tactics in the Tennessee litigation raise a question as to whether Debtor's management will have the borrowing public's or the servicemen claimants' interest at heart when it negotiates with the states. This alone argues for appointment of an independent trustee.

The Debtor's actions in allowing Rome LLC and RCC to take over parts of its' business and the Debtor's allocation of gross profits (without any allocation of overhead) to the Collins IRA, independently justifies appointment of a trustee to investigate and to bring any actions necessary to reclaim profits from those entities and their principles. *See In re Great Northeastern Lumber & Millwork Corporation,* 20 B.R. 610, 611 (Bkrtcy. E.D. Pa. 1982); *see also In re W.R. Grace & Co.*, 285 B.R. 148 (Bkrtcy.D.Del 2002).

C. If The Court Does Not Order Appointment of a Trustee, it Should Order Appointment of an Examiner To Investigate the Above Allegations Because An Examiner Would be in the Best Interests of the Estate and the Public.

If the Court decides not to order appointment of a trustee, the Code requires appointment of an examiner in certain circumstances. 11 U.S.C. § 1104(c). If the Court orders appointment of an examiner, the Court must also determine the scope of the examination. The examiner's job is to examine, not to act as a protagonist in the proceedings. *In re Gliatech, Inc.,* 305 B.R. 832, 836 (Bkrtcy.N.D. Ohio 2004) (citing *In re W.R. Grace & Co. 285 B.R. 148, 156 (Bankr.D.Del.2002))* The Court can craft the reach of the examination to that which the Court feels appropriate. For example, in this case, the Court could limit the examination to a report on whether the Debtor is in compliance with consumer protection and securities laws and possible recovery or equitable subordination rights against Mr. Collins. The allegations of mismanagement will not be reargued here, as they are all contained above.

The Code speaks of allegations. Here it is clear that the allegations are supported by substantial evidence. *In re Bel Air Associates, Ltd.,* 4 B.R. 168 (Bkrtcy.W.D.Ok 1980) ("...[A]lthough there is no requirement that actual misconduct or incompetence be proved, there should at least be some evidence presented that such allegations have some factual basis.")

D. Appointment of an Examiner is Mandatory In This Case.

If the Court decides not to order appointment of a trustee, appointment of an examiner is required if the U.S. Trustee requests one and the debtor's fixed, liquidated, unsecured debts, other than debts for goods, services, or taxes, or owing to an insider, exceed $5 million. 11 U.S.C. § 1104(c)(2). *In re Revco D.S., Inc.,* 898 F.2d 498 (6th Cir. 1990). The Debtor's fixed liquidated, unsecured debt other than for goods, services or taxes exceed $60 million.

Prayer

The Acting U.S. Trustee requests the Court to order appointment of a trustee or an examiner in this case.

Dated: December 8, 2008

Respectfully submitted,

Sara L. Kistler,
Acting United States Trustee

By: /s/ Matthew R. Kretzer
Matthew R. Kretzer,
Attorney for the Acting U.S. Trustee